No. 15,651

United States Court of Appeals

For the Ninth Circuit

AMERICAN RADIATOR AND STANDARD SANITARY CORPORATION, a Corporation,

Appellant,

vs.

L. L. FORBES and A. W. BODINE, Doing Business as L. L. FORBES CONSTRUCTION COMPANY, and THE HOME INDEMNITY COMPANY, a Corporation,

Appellees.

Appeal from the United States District Court for the District of Arizona.

APPELLANT'S REPLY BRIEF.

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ADDITIONAL AUTHORITIES SUBMITTED BY APPELLANT

The provisions of Section 67-2318(a), Arizona Code Annotated 1939 (1952 Supp.) became a part of the bond. Porter v. Eyer, 80 Ariz. 169, 294 P.2d 661 (1956).

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CONCERNING APPELLEES' STATEMENT OF THE CASE.

Both in the portion of the Appellees' Brief entitled "Statement of the Case" and throughout the argument, Appellees have stated that this action was brought solely upon the contractor's bond. This, of course, is wholly without foundation. We thought it was eminently clear from the pleadings, the record

and the organization of our opening brief that American Radiator seeks recovery against Forbes on the contract and against Forbes and the Bonding Company on the bond of which both the contract and the Arizona statute are integral parts. Surely there is nothing in the Amended Complaint which can be said to constitute an election to rely solely upon the bond. The Amended Complaint simply alleges that Forbes undertook to perform the construction of the school buildings pursuant to a contract with the School District and that the Bonding Company and Forbes executed and delivered to the School District a bond conditioned upon the faithful performance of the contract. The prayer is for judgment against the defendants and each of them in the sum claimed. Until the filing of Appellees' Brief, it was never suggested in their behalf that the issue of liability of Forbes under the contract was excluded from the consideration of the court. In fact, the Findings of Fact and Conclusions of Law which were prepared on behalf of Appellees contain two express Conclusions that the contract between Forbes and the School District was not for the benefit of third parties, including the plaintiff (R. 25). Surely there would have been no occasion to adopt Conclusions with respect to the legal effect of the contract if the action was only upon the bond.

Appellees have also from time to time questioned the propriety of our statement that the bond was conditioned upon the faithful performance of the contract by Forbes. It is true that the Bonding Company

attempted to limit its obligation to that of an indemnitor by adopting appropriate wording in the instrument. We do not, of course, assert that language of indemnification is not to be found in the bond. We do assert that *as a matter of law* the language of indemnification is figuratively obliterated by the express statutory requirement that a contractor's bond shall be conditioned upon the faithful performance of the contract. Having once articulated this reasoning, we thereafter adopted the short-cut device of stating that the bond furnished by the Bonding Company was conditioned on the faithful performance of the contract by Forbes.

Finally, Appellees take issue with our statement that the action was brought by American Radiator to recover the unpaid balance of the purchase price of materials which it furnished for installation in the classroom additions to Sunnyslope High School. Appellees assert that there is no justification in the record for such a statement and that it falsely implies that American Radiator furnished the materials with the intent that they should be installed and used in the construction of the school buildings. Appellees' assertion is without merit. The Agreed Statement of Facts contains the following statement:

> "Bachman purchased plumbing materials and supplies from the plaintiff, American Radiator and Standard Corporation, *to install in the job.*" (R. 15).

The court found this to be the fact in the exact words used in the Agreed Statement (R. 24). While

we do not regard the interpretation of this language as being controlling, we do assert that it fully justifies the inference that American Radiator furnished the materials in conscious anticipation that they would be installed in the job.

ARGUMENT.

I.

THE CONTRACT.

Because of Appellees insistence that this action is solely upon the bond, we assert again that American Radiator seeks recovery from Forbes because of his contractual undertaking to provide and pay for all materials necessary to complete the work. This liability would accrue whether there were a performance bond or not and forms the basis for a judgment against Forbes even if this court were to hold that the Bonding Company had successfully limited its liability by incorporation in the bond of what we regard as unlawful escape clauses.

The burden of Appellees' argument in respect to the legal consequences of the contractual undertaking to provide and pay for all materials necessary to complete the work is that the parties did not intend to benefit laborers and materialmen. This result is thought to arise from a reading of the provisions of the contract. We submit that there is no language in the contract which compels the conclusion that the parties intended to exclude recovery by materialmen.

The contractor has promised to provide and *pay for* all materials. Such an undertaking is fairly subject to the interpretation that the parties intended to extend the benefits of the contract to those persons entitled to be paid for the materials which the contractor agreed to furnish and for which he agreed to pay.

Appellees assert that we have advanced neither argument nor authority for our contention that the contract was intended for the benefit of third parties, including American Radiator. We are wondering whether Appellees' counsel have read that part of our brief which relates to an exhaustive analysis of the decision of the Supreme Court of Indiana in *Knight & Jillson Co. v. Castle,* 172 Ind. 97, 87 N.E. 976, 27 L.R.A. (N.S. 573 (Appellant's Brief, p. 15, *et seq.*). In that case, as we have stated, the contractor's agreement to pay for all labor and materials used in the work was held, as a matter of law, to be a third party beneficiary contract which inured to the benefit of a materialman even though the materialman, at the time of extending credit, had no knowledge of the existence of the contractual undertaking. In an effort to distinguish the *Knight & Jillson* case, Appellees say (Brief, p. 12) that American Radiator's attempted recourse against the contractor and the Bonding Company "was strictly an after-thought". Althought we challenge the record for any evidence justifying that inference, under the rule of *Knight & Jillson,* the rights of the materialman are not affected by the circumstance that he did not know of or anticipate asserting rights which he had as a third party beneficiary of the underlying contract.

Appellees next seek to distinguish the *Knight & Jillson* case by saying that the bond was conditioned upon the faithful performance of the contract by the contractor. Two answers readily present themselves. The first is that Forbes is liable under the contract irrespective of the provisions of the bond. The second answer is that if the Bonding Company and Forbes had written a bond containing language which complied with the Arizona statute, it would have been conditioned upon the faithful performance of the contract by Forbes and would have been identical to the bond provided by the contractor in the *Knight & Jillson* case. Finally, Appellees attempt to avoid the *Knight & Jillson* case by pointing out that American Radiator supplied to a subcontractor, whereas Knight & Jillson Company supplied the general contractor. We anticipated this distinction in our discussion commencing at Page 17 of our opening brief in which we cited and quoted from the Fourth Circuit decision in *Standard Acc. Ins. Co. v. Simpson,* 64 F. 2d 583. Appellees dismiss the *Standard Accident* case with the comment that the bond was given pursuant to statute (Brief, p. 13). They misconceive the purpose of our citing the decision. We offered it for the purpose of assisting the court in construing Forbes' promise to provide and pay for all material necessary to complete the work. The issue, of course, is whether this language constitutes a promise to pay persons who supply materials to a subcontractor as distinguished from the general contractor. The *Standard Accident* case held that the agreement to "pay when and as due all lawful claims for labor performed or materials and

supplies furnished for use in and about the construction of said highway or highway structures'' constituted a promise to pay persons supplying materials to a subcontractor. It happens that in that case the quoted language appeared in the bond rather than in the contract. While this fact might make a difference to the Bonding Company, it is all the same as respects the liability of the contractor whether he makes such a promise in his construction contract or in his bond.

Hipwell v. National Surety Co. 130 Iowa 656, 105 N.W. 318, 319, (Appellant's Brief, p. 19), again provides a judicial construction of a written promise to ''pay for all labor and materials used in and about the building''. Wholly apart from any statutory requirement with respect to bonds, the Iowa Supreme Court held that this language constituted a promise to pay persons who supplied materials to subcontractors. Unlike the *Standard Accident* case, the *Hipwell* case was concerned with the interpretation of the contract and not the bond.

II

THE BOND.

Here again, for the sake of clarity and because of apparent confusion on the part of the Appellees, we restate our position. We seek to hold both Forbes and the Bonding Company upon the principle that the contract contained Forbes' promise to pay the claims of persons supplying materials to a subcontractor, that if Forbes and the Bonding Company had written

a bond conditioned on the faithful performance of the contract by Forbes (as they were compelled to do under the provisions of the Arizona statute) the obligation of the parties under the bond would have been to pay material suppliers to subcontractors and that, as a matter of law, the statutory requirement for a performance bond made the bond a performance bond in spite of any conflicting language contained in the instrument.

The only way in which Forbes and the Bonding Company can possibly hope to avoid liability under the bond is by successfully asserting that the escape clauses are valid. We are entirely in agreement that if the bond is to be enforced only in accordance with its express language, the Bonding Company is not liable. What we do not understand is how Appellees can hope to avail themselves of the escape provisions of the bond when admittedly their insertion in the instrument was wholly repugnant to the express requirement of the statute pursuant to which the bond was furnished. In our view, as we had hoped to demonstrate by our opening brief, if a contractor and a surety company execute and deliver what purports to be a performance bond and in compliance with an express statutory command, any efforts which they may make between themselves by a written instrument to change it into an indemnity bond or to limit the obligation of the surety to something less than the undertakings of the contract ought to be looked upon as unlawful and void. The only case which Appellees have cited in pretended support of this position is *Massachusetts Bonding & Ins. Co. v. United States R.*

Corp., 265 Ky. 661, 97 S.W. 2d 586. In that case the contract required the contractor to furnish a bond covering the faithful performance of the contract. The bond which was in fact furnished contained limitations which were not contemplated by the terms of the contract. As in the case at bar, the parties limited the condition of the bond to the indemnification of the School District against loss or damage arising out of the failure of the contractor to perform. The court readily conceded that if the parties had furnished a performance bond as required by the contract, the materialmen could have recovered. It held, however, that if the parties furnished a bond which did not meet the requirements of the contract, the surety could limit its obligations to the express condition of the instrument. The significant difference is, of course, that in the *Massachusetts Bonding* case the duty to furnish a performance bond arose only out of the contract and not out of statute as did Forbes' duty. We are not persuaded that Kentucky would follow the rule of the *Massachusetts Bonding* case if the duty to furnish a performance bond were created by law rather than by agreement. In cases in which the parties furnish a true performance bond in compliance with the contract, Kentucky holds both the contractor and the surety liable to materialmen. See, for example, *Royal Indemnity Co. v. International Time Recording Co. of New York,* 255 Ky. 823, 75 S.W. 2d 527, in which the contract provided that the contractor "will promptly pay for all labor performed and all material used or furnished in completing said work and carrying out this contract."

Appellees rely heavily upon a series of quotations from 78 Corpus Juris Secundum which in general relieve a surety of liability on a contractor's bond which is conditioned merely on the indemnification of the named obligee. None of these quotations purports to hold that a surety can so limit its liability in the face of an express statutory requirement for a general performance bond. For example, the quotation from 78 C.J.S. at p. 1293 opens with the words "In the absence of statute . . ." At Page 17 of Appellees' Brief is a quotation of the headnote appearing in 78 C.J.S. at p. 1271. This headnote states in part, ". . . a bond for faithful performance, but not for payments of claims of laborers and materialmen, does not inure to the benefit of laborers and materialmen". This, of course, begs the question for the reason that a faithful performance bond is in law one for the payment of claims of laborers and materialmen if such a promise is found in the contract whose performance the bond guarantees. This is more precisely spelled out in the text following the quoted headnote in which the author says (p. 1272):

> "Moreover, a bond securing faithful performance of a contract, providing that the contractor should provide all materials and perform all labor *but not providing that he will pay for such materials and labor,* does not inure to the benefit of materialmen and laborers." (Emphasis supplied.)

In our case, of course, Forbes agreed both to provide and to pay for materials and labor. The text would appear to be conclusive authority for recovery by American Radiator.

Appellees also rely on the early decision of the Circuit Court for the Northern District of Iowa in *United States v. Farley,* 91 Fed. 474, in which an undertaking in the bond to pay all persons supplying the contractor with labor or materials was held to extend to direct suppliers to the contractor but not laborers employed by a subcontractor. Reference to Shepard's Citator would have led Appellees to the decision of the Court of Appeals for the District of Columbia in *United States v. James Baird Co.,* 73 F. 2d 652, 654, in which the court said that the rule of the *Farley* case was discarded by the United States Supreme Court in 1906. For the last 51 years, bonds like the one considered in the *Farley* case are uniformly construed to protect persons who supply labor and materials to subcontractors even though they expressly cover only labor and materials furnished to the prime contractor.

At Page 22 of their brief, Appellees seek to distinguish *Webb v. Crane Co.,* 52 Ariz. 299, 80 P. 2d 698, on the purported ground that the Webb bond expressly gave third parties a right to sue on the bond directly. This is simply not the fact. At p. 304 of the Arizona Reports, the Supreme Court said:

> "Neither the contract nor the performance bond itself gives in express terms a direct right of action on the bond to materialmen . . ."

Notwithstanding this circumstance, the court held that the bond was a third party beneficiary bond upon which the subcontractor's materialman could sue and recover.

The Arizona Supreme Court decision in *Ward v. Johnson,* 72 Ariz. 213, 232 P. 2d 960, cited at page 21 of Appellees' Brief, has no application to the issue now before the court. In that case, Johnson sued two Tolleson police officers and their bonding company for false arrest and imprisonment. Under the express provisions of the bonds, they ran solely to the town of Tolleson and did not inure to other persons who might be aggrieved by the wrongful act of the bonded officers. The bonds were not furnished pursuant to any statutory requirement. The court held that the surety, in the absence of a statutory provision to the contrary, could lawfully limit its undertaking on the bonds. By way of dicta, the court said that if the officers' bonds had been "official bonds", such obligations as are stipulated by the applicable Arizona statute relating to official bonds would have been imposed on the surety whether they had been inserted in the written instruments or not. Following the language quoted by Appellees, the Supreme Court said:

> "The above rule is subject to the principle that all contracts are governed by the laws of the jurisdiction which exist at the time of their execution."

Actually, the most salient difference between the *Ward* case and the case at bar is that the police officers bonds were not, as here, given to assure the faithful performance of a contract containing express promises for the benefit of third parties.

III

THE CONSTRUCTIVE TRUST.

No purpose would be served by repeating our position in respect to this separate theory of recovery against Forbes. The essential difference between the parties seems to lie in the interpretation of the words "satisfactory receipts", as contained in the Arizona statute. Appellees insist that the requirement of the statute is met by obtaining from the subcontractor a receipt evidencing payment to him of the contract price. Obviously, the contract price includes insurance premiums, cost of complying with the Workmen's Compensation laws, overhead and profit to the subcontractor, as well as his material and labor costs. We cannot conceive how a receipt from the subcontractor could constitute evidence of payment of labor and material bills.

Again, the requirement of the retention of 10% of all estimates as a guarantee of the complete performance of the contract was intended, like the requirement for a performance bond, to provide separate assurance that the contractor would do everything which he promised to do in his written contract. If, as a matter of law, he is held to have promised to pay materialmen and laborers, then the retention requirement guaranteed the fulfillment of that promise.

Appellees' alarm over the possibility that a steel mill which provided raw materials for pipe or even a mining company which provided ore for the steel mill might seek the protection of the bond and of the statute is a departure from reality. Clearly, the pur-

pose of the Legislature in providing the guarantees of a performance bond and a retention fund was to safeguard materialmen and laborers who were deprived of a lien because of the public nature of the work. *Webb v. Crane Co.,* 52 Ariz. 299, 80 P. 2d 698. Unquestionably, a materialman like American Radiator supplying pipe and plumbing fixtures which are incorporated in a privately owned structure has the right to perfect and foreclose a lien. This is true whether the material is supplied to the general contractor or to a subcontractor. This right of lien has never been extended to a steel mill providing raw materials or to a mining company providing ore to the steel mill.

CONCLUSION.

Appellees are concerned with the supposed inequity of our position which seeks to compel Forbes to satisfy American Radiator when Forbes has already paid Bachman in full. Appellees forget that Forbes was in the best position to protect itself by one or both of two simple expedients. Forbes, like countless other general contractors, could have exacted from Bachman a bond conditioned upon the payment of labor and material bills, or he could have retained all or a part of the balance due Bachman until Bachman had furnished Forbes with receipts from his laborers and materialmen. The inequity of double payment is always decried by persons against whom mechanics' and materialmen's liens are asserted, but to date this defense has never been successfully asserted to defeat the fore-

closure of such liens. If Forbes paid Bachman in full without satisfactory evidence of the payment of American Radiator's bill, he paid at his peril. And it is of more than passing interest to note that in this case Forbes had actual notice by letter mailed two days after the completion of the job that American Radiator had not been paid.

For the reasons hereinabove stated, the judgment of the District Court should be reversed.

Dated, Phoenix, Arizona,
November 29, 1957.

Respectfully submitted,

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